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October 24, 2003

***To the Citizens of the Commonwealth of Massachusetts,
Governor Mitt Romney, and Honorable Members of the
General Court***

I am pleased to present to you the Statutory Basis Financial Report (SBFR) of the Commonwealth for the fiscal year ended June 30, 2003 (FY03).

The financial difficulties that began for the Commonwealth in fiscal 2002, continued in FY03. Tax revenues from all sources enjoyed a moderate increase of 4.8% after a drop of 15.2% in FY02. Unfortunately, unemployment has continued to hover between 5.2% and 5.7% for the entire year, slightly better than the rest of the nation as a whole.

To combat these difficulties, the Commonwealth made difficult decisions. The Governor and the former Governor used powers under Massachusetts General Laws to cut budgeted spending during the fiscal year. Local government aid and lottery distributions to cities and towns were reduced. Spending cuts were made to programs including Medicaid, education, higher education, transitional assistance and other health and human services programs. Many fees were increased Commonwealth-wide from deeds filing fees to higher education activity fees, certain tax loopholes were also closed and revenues were generated through a tax amnesty program. All of the receipts from the tobacco settlement were appropriated in FY03 and \$550 million was transferred from the Stabilization Fund to balance the budget. Finally, the Commonwealth through the FY04 general appropriation act improved statutory financial reporting by redefining consolidated net surplus to include all budgeted funds. Along with this action, the Commonwealth has closed 51 budgeted, capital projects and trust funds. All of their future activity will be reported in the General Fund or the General Capital Project Funds. Several other minor funds were also moved from budgeted to non-budgeted or trust activity. These accomplishments are very important in improving the representational faithfulness of budgeting and operating results.

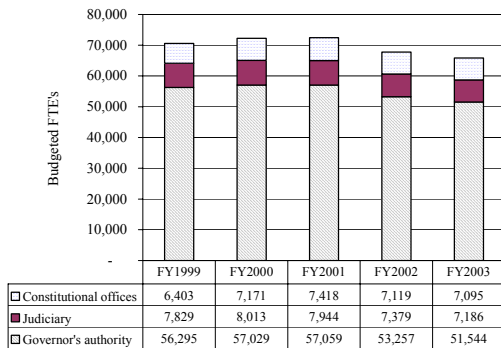
With this in mind, I am reporting that the Commonwealth finished the year ended June 30, 2003 with a consolidated net surplus of approximately \$150.9 million. Of this amount \$75.7 million has been transferred to the Stabilization Fund. This surplus represents less than three days of government operations. Our financial picture will remain cautious for the near future.

Financial Highlights

To meet the fiscal challenges of FY03 and beyond, the Commonwealth continued to take extraordinary measures to maintain fiscal balance.

- \$550 million was removed from the Stabilization Fund on July 1. However, at the close of the fiscal year, \$227.4 million was redeposited into the fund from tax loophole closure and fund closure. An additional \$75.7 million was transferred to the fund from surplus. Beginning in FY05, an additional 0.5% of current year net tax revenues must be deposited into the Stabilization Fund before the year – end surplus is determined in addition to the current statutorily required carry-forward amount. Finally, the ceiling on the balance in the Stabilization Fund was increased from 10% to 15% of total current year budgeted revenues.
- All of the tobacco settlement proceeds for the year were used for current operations, up from 50% in the prior year.
- \$39 million was removed from surplus funds previously set aside for capital projects from previous years for current operations.
- The Commonwealth refunded over \$3 billion in general obligation bonds, taking advantage of some of the lowest interest rates in history. We prudently refrained from issuing tobacco settlement bonds or pension obligation bonds, which many of our peer states have either considered or sold.
- Approximately \$213.2 million of Medicaid related spending has been moved off budget, funded by fees and related federal financial participation. Enrollment in Medicaid has increased by 3%.
- There was a \$937 million net decrease from the Unemployment Compensation Fund, reducing an ending balance to approximately \$491 million. The Department of Employment and Training estimates that the fund will be operating at a deficit by January 2004. State law provides that in the event of a deficit in the Fund that is not paid back by September 2004, additional revenues will be collected from employers in order to pay the interest that has accrued on the debt.
- In FY04, the pension obligation has been moved “off budget,” using transfers of surplus and the transfer of the value of the Hynes Convention Center and the Boston Common Garage from the Massachusetts Convention Center Authority to the Pension Reserves Investment Trust.

***Budgeted Full Time Equivalent
Workforce
Including Budgeted Higher Education
June 1999 – June 2003***



The Commonwealth also took measures operationally to achieve balance.

- The budgeted full time equivalent workforce, including budgeted higher education equivalent count dropped from 67,755 as of June 2002 to 65,825 as of June 2003. The FY04 General Appropriation Act included another employee retirement incentive reduction plan. The graphic to the left details the reductions over the last five years.
- Starting in FY04, the employee's share of group health insurance premiums will increase from 15% to 20% of the cost of the insurance for those who earn more than \$35,000. All new employees hired after June 30, 2003 will contribute 25% of the cost of the insurance, regardless of salary.
- Tax decreases put in place earlier than FY02 were frozen. The income tax rate remains at 5.3%. The graduated capital gains tax portion has also been frozen at 5.3%. Charitable deductions were eliminated and cigarette tax rates have doubled to \$1.51 per pack.

Overview of the Financial Statements

This report includes the reports on the activity and balances of the budgeted funds, non-budgeted special revenue funds, capital project funds, fiduciary funds and the non-appropriated funds of higher education.

The financial operations of these funds are maintained in the Massachusetts Management Accounting and Reporting System, (MMARS). The statewide accounting system is operated by the Commonwealth and contains detailed information summarized in this report.

The SBFR is intended to satisfy the requirements of state finance law, and to present fairly the results of FY03 activity in the Commonwealth's funds. The report contains computations required by state finance law, including the certification of the Stabilization Fund and Tax Reduction Fund.

Basis of Accounting

The statutory basis of accounting, defined in Massachusetts law, is typically used to budget and control fiscal operations. The statutory basis of accounting is not in conformity with accounting principles generally accepted in the United States of America, (GAAP) as defined for governments by the Government Accounting Standards Board (GASB). This report's purpose is to document compliance with Massachusetts state finance law. I will report the Commonwealth's financial position on a GAAP basis in December, in our Comprehensive Annual Financial Report, (CAFR). This report, which will be prepared in accordance with GAAP, provides a basis for comparison with other governments. There is a major divergence between what is contained in the SBFR fund balance, revenues and expenditures and what will be presented in December under GAAP. The major differences include

presentation of the historical cost of infrastructure, the recording of depreciation expense, the presentation of all types of debt on the face of the financial statements and the presentation of those financial statements in an all – encompassing, net assets and net expense format.

In accordance with Massachusetts General Laws, the Office of the Comptroller transmits the SBFR on or before October 31st. The SBFR report for fiscal year ended June 30, 2003 herein is audited by Deloitte & Touche, Independent Certified Public Accountants, and represents the conclusion of financial activity and the closing of the Commonwealth's books on the statutory basis of accounting for the fiscal year. This audit is conducted in conjunction with the Office of the State Auditor, which provides knowledge, expertise and resources to close and audit the financial statements.

This report includes the budgeted funds, non-budgeted special revenue funds, capital project funds, fiduciary funds and the non-appropriated funds of higher education.

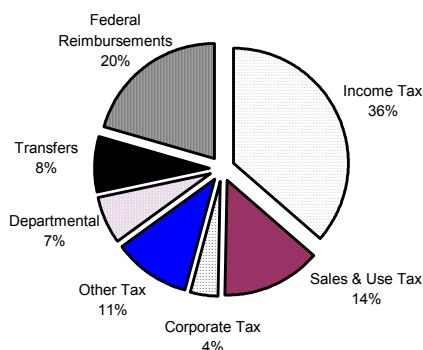
The financial operations of these funds are maintained in the Massachusetts Management Accounting and Reporting System, (MMARS). The statewide accounting system is operated by the Commonwealth and contains detailed information summarized in this report. This system, in place since 1986, will be retired at the close of FY04, as it will be replaced by a web – based system, NewMMARS.

The Budgeted Funds

For FY03, expenditures and other uses of budgeted funds continued to exceed revenues and other sources of budgeted funds, resulting in an operating deficit of \$451.9 million. This deficit is indicative of the ongoing economic downturn.

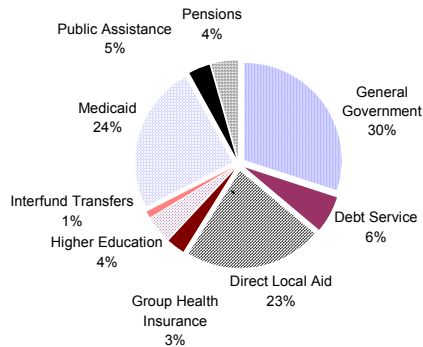
Any surplus or deficit has to be viewed in a trend. Generally accepted standards indicate that a structural balance is achieved when revenues exceed expenditures over a period of multiple years. Prior to FY02, the Commonwealth had over a decade-long record of operating gains. Throughout FY03, for the second year, the budget balance continued to rely on significant use of prior year surpluses. Much of the accumulated prior year surplus balances have been used to balance the current year budget. In FY04 and in future years, the challenge will be to match spending to available revenues.

Budgeted Revenues and Other Sources



In FY03, budgeted revenues and other sources increased 3.8% from FY02 reflecting slight increases in tax revenues. Federal reimbursements also rose, though largely from increases in Medicaid reimbursements and approximately \$58 million received in the form of a federal Medicaid Assistance Percentage (FMAP) payment pursuant to the federal Jobs and Growth Reconciliation Act of 2003. From a multi-year perspective, the proportion of revenue sources by category to total budgeted revenues and other sources showed a slight increase of 0.3% in taxes with corresponding drops in departmental and other revenues and interfund transfers. Personal income and sales taxes continue to be the largest sources of tax revenue for the Commonwealth. Corporate

Budgeted Expenditures and Other Uses



tax revenue rose this year, surpassing fuel revenue, while cigarette tax revenue more than doubled due to increased tax rates.

Budgeted expenditures and other uses, including transfers decreased by 1.6%. This is reflective of fiscal budgetary tightening, with a decrease of nearly 2% or \$400 million in programs and services expenditures. The Budgeted Funds – Operations table on page 6 displays the FY03 summary of budgeted funds, compared to FY02. The FY03 financial statements for each of the 57 individual budgeted funds are included in the financial section of this report.

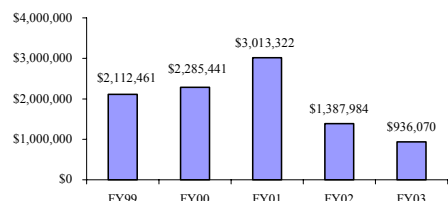
In conducting the budget process, the Commonwealth excludes those “interfund” transactions within the budgeted funds that are included in this report because by their nature, have no impact on the combined fund balance of the budgeted funds. The table Budgeted Funds – Operations isolates this “interfund” activity from the budgeted sources and uses to align forecasts prepared during the budget process to actual amounts in this report. Transfers among the Budgeted Funds increased this year due to amounts transferred from stabilization to other funds to balance the budget for the year. A detailed list of these interfund transfers is included in Note 3 to the general purpose financial statements.

The graph of Budgeted Funds – Fund Balance, on page 7, shows the combined fund balance in the budgeted funds for the past five years. This “bottom line” perspective demonstrates the accumulation of resources attributable to balanced budgets through FY01 and the reliance on these resources in FY02 and FY03 as spending was adjusted to align with the lower revenue base. Note that in FY04, this definition will include all remaining budgeted funds. The FY03 ending balance of \$936.1 million is composed of three items. The Stabilization Fund balance of \$641.3 million is the largest component. The other components include \$218.0 million undesignated surplus available for appropriation in FY04 and \$76.7 million reserved and designated for continuing appropriations and debt service. With the current state of the economy, we now realize the importance of the balance in the Stabilization Fund and its direct correlation to the financial condition of the Commonwealth.

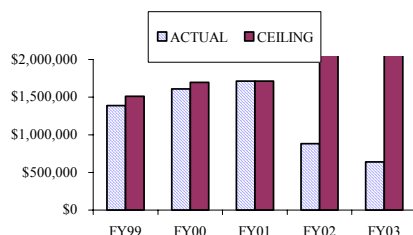
Budgeted Funds - Operations
(Amounts in thousands)

	2002	2003
Beginning fund balances:		
Reserved and designated.....	\$ 895,260	\$ 195,173
Reserved for Tax Reduction	33,565	-
Reserved for Stabilization Fund.....	1,714,990	881,771
Undesignated.....	369,507	311,040
Total.....	<u>3,013,322</u>	<u>1,387,984</u>
Revenues and other sources:		
Taxes.....	13,622,710	14,279,567
Federal reimbursements.....	4,334,934	4,523,648
Departmental and other revenues.....	1,485,249	1,494,755
Interfund transfers from non-budgeted funds and other sources.....	1,732,024	1,689,198
Budgeted revenues and other sources.....	<u>21,174,917</u>	<u>21,987,168</u>
Intragovernmental Service Fund revenues.....	115,226	117,223
Interfund transfers among budgeted funds and other sources.....	1,759,205	3,193,296
Total revenues and other sources.....	<u>23,049,348</u>	<u>25,297,687</u>
Expenditures and other uses:		
Programs and services.....	20,412,684	20,022,626
Debt service.....	1,304,735	1,373,409
Pension.....	795,782	813,469
Interfund transfers to non-budgeted funds and other uses.....	287,054	229,579
Budgeted expenditures and other uses.....	<u>22,800,255</u>	<u>22,439,083</u>
Intragovernmental Service Fund expenditures.....	115,226	117,223
Interfund transfers among budgeted funds and other uses.....	1,759,205	3,193,296
Total expenditures and other uses.....	<u>24,674,686</u>	<u>25,749,602</u>
Excess (deficiency) of revenues and other sources over expenditures and other uses.....	<u>(1,625,338)</u>	<u>(451,914)</u>
Ending fund balances:		
Reserved and designated.....	195,173	76,735
Reserved for Stabilization Fund.....	881,771	641,325
Undesignated.....	311,040	218,010
Total.....	<u>\$ 1,387,984</u>	<u>\$ 936,070</u>

**Budgeted Funds – Fund Balance
(Amounts in Thousands)**



**Stabilization Fund –
Fund Balance
(Amounts in Thousands)**



State finance law, as amended during FY03, increased the maximum balance that may accumulate in the stabilization fund to a level of 10% of budgeted revenues and other sources. For FY04, this ceiling has increased to 15%. The law then directs that any amount in excess of this “cap” be transferred to the Tax Reduction Fund for future, one-time, personal income tax rebates. Due to the significant transfer out of stabilization, it will be a while before the “cap” will be reached. The details of these calculations can be found on pages 334 through 339 of this report.

The graph, Stabilization Fund Balance portrays this “cap” and the balance of the fund over a five-year period. Despite the Commonwealth’s positive financial condition, a few cautionary notes are merited. There are certain problems with the definitions in the state finance law, enacted in 1986 and continued with slight modifications to the present. A balanced budget, defined as the “Consolidated Net Surplus,” is the combined undesignated fund balance of the General, Local Aid, and Highway Funds. According to this restricted definition, fiscal balance was achieved in FY03. This definition has been redefined to include all budgeted funds starting in FY04.

Under current general laws, an amount equal to 0.5% of tax revenues is retained in the funds contributing to the calculation. Beginning in FY05, an additional .5% of current year tax revenues must be deposited in stabilization before the year end surplus is determined.

Further complicating this issue was the existence of a large number of “minor” budgeted funds. Over the past several years, dozens of new “minor” funds were created. These funds split off revenues and expenditures previously accounted for as part of a major fund, such as the General Fund. A number of these funds had structural imbalances leading to chronic deficits. The trend to fragment the budget into such special interest funds was addressed with consolidation and closure of the majority of those funds as of June 30, 2003. We applaud the Legislature and the Governor for taking this step.

**Stabilization Fund Activity
in FY 2003
(Amounts in Thousands)**

Balance as of June 30, 2002	\$ 881,771
Add: Investment income	6,456
Tax loophole closure revenue	110,074
Insurance demutualization revenue	76,546
Transfers from repealed funds	40,805
Subtotal	1,115,652
June 30th Consolidated Net Surplus transfer	75,673
Subtotal	1,191,325
Less: July 1st Budgeted transfer from stabilization	(550,000)
Balance as of June 30, 2003	<u>\$ 641,325</u>

The Non-Budgeted Funds

The Non-Budgeted Funds represent operations in which the government has imposed its sovereign authority, but has excluded these operations from the annual budget process. During FY03, the Commonwealth maintained 34 of these funds. The largest funds include the Lottery, Federal Grants, Debt Defeasance, Health Care Security Trust (the recipient of tobacco settlement funds), Grant Anticipation, Sewer Rate Relief, the Medical Security Trust, the new Health Care Quality Improvement Fund and the Uncompensated Care Funds. The Open Space Acquisition Fund was added and repealed this year with no activity. In FY04, the Convention and Exhibition Center Fund will become Non-Budgeted. These funds are commonly referred to as special or dedicated revenue funds whose revenues are matched to related expenditures.

The table, Non-Budgeted Funds – Operations, includes a summary of the FY03 non-budgeted funds. Financial statements for each of the individual funds are included in the financial section of this report. Several of these funds are worth mentioning. At June 30, 2003, the Federal Grants Fund had a positive fund balance, but there is a deficiency in cash within the fund. This situation results in the Commonwealth drawing funds from the federal government a few days after applicable cash disbursements to assure an “interest neutral” timing of the federal – state cash exchange. These requirements were established by the Cash Management Improvement Act of 1990. Within the Lottery Funds, gross revenues continued to increase this fiscal year. The Lottery continues to be a strong source of cash flow for the Commonwealth.

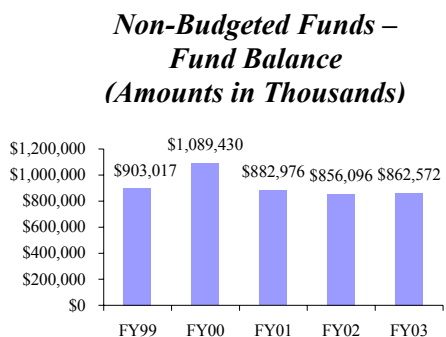
Non-Budgeted Funds - Operations (Amounts in thousands)

	2002	2003
Beginning fund balance.....	\$ 882,976	\$ 856,096
Revenues and other sources:		
Taxes.....	718,621	752,775
Assessments.....	452,510	526,888
Federal grants and reimbursements.....	2,496,932	2,855,445
Tobacco Settlement revenue.....	304,518	300,039
Departmental and miscellaneous.....	5,041,971	4,996,883
Transfers and other sources.....	434,493	498,872
Total revenues and sources.....	9,449,045	9,930,902
Expenditures and other uses:		
Programs and services.....	7,199,414	7,560,198
Debt service.....	77,413	77,200
Transfers and other uses.....	2,199,098	2,287,028
Total expenditures and uses.....	9,475,925	9,924,426
Excess (deficiency) of revenues and other sources over expenditures and other uses.....	(26,880)	6,476
Ending fund balance.....	\$ 856,096	\$ 862,572

The Health Care Security Trust Fund receives all revenues from the Master Settlement Agreement (MSA) between the states and the tobacco industry to recover healthcare costs for tobacco related illnesses. The MSA estimates the Commonwealth revenues for the first 25 years of the settlement to be approximately \$7.6 billion. However, this estimate is prior to future adjustments, including adjustments for inflation and changes in the volume of domestic cigarette sales. In FY03, the Commonwealth received over \$300 million or 88.5% of the estimated amounts shown in the MSA. All proceeds received in FY03 were transferred to the Tobacco Settlement Fund, a budgeted fund. The Fund was also used as a cash flow mechanism for the new Health Care Quality Improvement Fund. The decline in Health Care Security Trust Fund (HST) assets is directly related to this financing provided as the HST invested assets had positive return on investment.

The Health Care Quality Improvement Fund (HCQIF) was established to accept transfers of fee revenue from nursing homes and pharmacies, along with applicable federal financial participation transferred from the HST. Subsequent to year-end, the Commonwealth returned \$18.8 million to pharmacies due to a judgement against the fees charged. This amount is reflected as a payable in the HCQIF. However, because of the way the HCQIF's programs are structured for FY04, there is a possibility that additional funds may have to come from the HST to finance those expenditures.

Federal Grant Anticipation Notes, (GANS) activity related to the Central Artery / Tunnel Project (CA/T) continued this year. During FY98, the Legislature authorized the issuance of up to \$1.5 billion in GANS to finance the current cash needs of the Project. These proceeds have been used to pay for federal grant - eligible expenses. From 2005 to 2015 these eligible expenses will be reimbursed by the federal government and the reimbursement will be used to payoff the GANS. As of June 30, 2002, all of the GANS had been issued. Subsequent to year-end, the Commonwealth completed a cross over refunding of the GANS. \$388.1 million in GANS issued in 1998 and 2000 at coupons ranging from 5.125% to 5.75% that will mature on December 15, 2008 and 2010, respectively, were partially refinanced with \$408.0 million of refunding notes with yields of 2.51% to 3.39%. The interest on the newly issued refunding notes is paid from an escrow until final redemption. This technique results in economic savings, but does not result in the defeased notes being removed from the Commonwealth's books until the maturity dates. The GANS mature between 7 to 17 years from the date of issuance and are redeemed by pledged future federal reimbursements. The GANS are not considered general obligation debt of the Commonwealth. Activity related to issuance of GANS and the accumulation of pledged funds and the payment of debt service is accounted for in the Grant Anticipation Note Trust Fund. The \$90 million surplus in FY03 represents \$80 million held for payment of interest on the GANS and \$10 million in cash from the GANS issuance that will be expended on the construction of the CA/T.



The universal health care funds, including the Uncompensated Care and Medical Security Trust Funds, have increased their annual revenue to nearly \$1.3 billion. However, \$117 million was transferred out to fund operations this year due to the lagging economy. As of the end of FY03, they have a combined fund balance of nearly \$143 million.

The graph Non-Budgeted Funds Balance shows the combined fund balance in the Non-Budgeted funds for the past five years. In each year, the entire balance is designated for the specific purpose of the fund. The only component of overall growth in fund balance in these funds this fiscal year was due largely to deposits into the Community Preservation Trust Fund. As indicated in previous years, more consolidation and elimination is needed for these funds. For example, the Government Land Bank Fund has a chronic structural fund deficit. The FY03 deficit balance of \$35 million remains an unbudgeted drain in cash flows in the General Fund. While steps have been taken to stop the growth in this deficit, the Fund should be abolished and the deficit transferred into the General Fund. An additional \$32 million deficit exists in the Motor Vehicle Inspection Fund. The enabling statute to the Fund mandates that the Fund must be in balance by June 30, 2005. There is no legislative consensus on a plan to resolve this deficit.

The Capital Projects Funds

The purpose of these funds is to construct or acquire capital assets for governmental use. The Governor may propose capital outlay budgets, which, upon enactment by the Legislature and approval by the Governor, become capital outlay acts. Capital outlay acts financed through the sale of debt require a two-thirds vote of the legislature. Numerous acts may be combined for reporting in an individual Capital Project Fund, but each act is accounted for separately within the Capital Projects Fund. These accounts record authorizations for expenditures in itemized capital appropriation accounts and equivalent authorizations to issue bonds or notes in anticipation of federal reimbursements.

The structure of these funds is that each capital outlay authorization is in balance, creating authorization for inflows, which may be from sales of bonds, federal reimbursements or other revenues and authorization for expenditures. Imbalances due to timing differences develop when the expenditure precedes the inflow of funds from the sale of bonds or federal reimbursements. Because of federal tax arbitrage rules, it is more difficult to sell bonds in anticipation of expenditures. The sale of bonds in advance is not commonplace in the Commonwealth.

The Commonwealth issued nearly \$5.0 billion in debt this year. Of this amount, \$1.9 billion to fund ongoing projects and over \$3.1 billion was in the form of general obligation refunding bonds, taking advantage of low interest rates. These refundings generated approximately \$127.8 million in present value debt service savings. Subsequent to year-end, the Commonwealth completed two additional refunding transactions which generated an additional \$47.6 million in present value debt service savings.

A significant portion of the Capital Projects activity continues to relate to the Central Artery / Tunnel Project (CA/T). The CA/T has been the target of an enormous amount of public scrutiny. The Commonwealth has aggressively responded to these concerns regarding the integrity of the cost estimates. For the third year, an independent evaluation of the entire estimate for the project has been undertaken. The current cost of

**Central Artery / Tunnel Project
(Amounts in Billions)**

Sources of Funds:	2002	2003
Federal Funds	\$7.049	\$7.049
GANS	1.500	1.500
Massachusetts Turnpike Authority	1.850	1.658
Massachusetts Port Authority	0.365	0.302
Other Commonwealth Debt	3.711	3.931
Commonwealth Operating Funds and Investment Earnings	0.150	0.185
Total Sources	\$14.625	\$14.625

Costs of Construction:	2002	2003
Actual Costs through end of FY	\$11.655	\$12.979
Estimated / Actual Spending for FY03	1.254	1.324
Estimated Spending:		
FY04	0.907	0.688
FY05	0.588	0.776
FY06	0.221	0.182
Total Estimated Costs of Construction:	\$14.625	\$14.625

the project stands at \$14.625 billion. The federal government has capped its contribution to this project and the finance plan includes state sources to fund the state share of the project. The project is over 89% complete as of June 30, 2003.

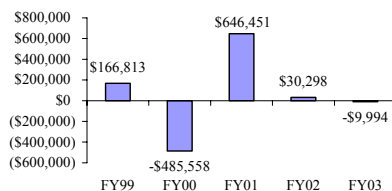
The east-west portion (Interstate 90) opened on January 18, 2003 and the northbound portion (Interstate 93) opened on March 29, 2003. The southbound portion (Interstate 93) is expected to open partially sometime between December 2003 and February 2004. Substantial completion is expected sometime between May and November 2005.

Pursuant to statute and agreements with the Massachusetts Turnpike Authority (the MTA) and the Massachusetts Port Authority (MassPort), the entities have committed to significant ongoing contributions to the Commonwealth as part of the financing for this project. These funds are in addition to funds from the Commonwealth and federal funds for the project.

The graph Capital Projects Funds – Fund Balance (Deficit) shows the combined fund balance in Capital Projects Funds for the past five years. The graph shows a deficit in the funds in FY03. The majority of these individual funds remain in deficit due to the timing differences between bonding and expenditure offset by one fund for central artery costs and one fund for the Convention Center where the Commonwealth is able to generate arbitrage revenues within the existing tax code.

The Capital Projects Funds – Operations table on the next page, includes the FY03 Capital Projects Funds, summarized and compared to FY02. Financial statements for each of the individual funds are included in the financial section of this report.

**Capital Projects Funds –
Fund Balance (Deficit)
(Amounts in Thousands)**



The Administration has implemented a coordinated fiscal strategy for the management of Capital Projects Funds. This strategy includes a five-year capital budget linked to debt management and cash management. The focus of this strategy is to manage capital spending and outstanding debt to levels the Administration considers appropriate for the Commonwealth. An important part of the strategy is to control capital spending within an annual administrative “cap.”

Capital Projects Funds - Operations
(Amounts in thousands)

	2002	2003
Beginning fund balance (deficit).....	\$ 646,451	\$ 30,298
Revenues and other sources:		
Federal grants and reimbursements.....	339	519
Departmental and miscellaneous.....	54,671	40,025
Payment from Authorities.....	-	104,914
General and special obligation financing.....	1,357,960	1,911,200
Proceeds of refunding bonds.....	1,501,415	3,398,240
Transfer for Federal Reimbursements.....	495,551	507,343
Transfer in due to debt defeasance	34,590	-
Transfers and other sources.....	292,661	284,750
Total revenues and other sources.....	3,737,187	6,246,991
Expenditures and other uses:		
Acquisition of assets.....	2,696,159	2,635,578
Payments to refunded bond escrow.....	1,276,562	3,398,240
Transfers and other uses.....	380,619	253,465
Total expenditures and other uses.....	4,353,340	6,287,283
Excess (deficiency) of revenues and other sources over expenditures and uses.....	(616,153)	(40,292)
Ending fund balance (deficit).....	\$ 30,298	\$ (9,994)

The Fiduciary Funds (Excluding Agency Funds)

The Fiduciary Funds record the Commonwealth's responsibility for assets it controls on behalf of other parties. Examples of such funds are the Unemployment Compensation and Pension Trust Funds. The table on the following page, which excludes assets held on a purely custodial capacity in so-called Agency Funds, summarizes the FY03 activity of the Fiduciary Funds. Over 84% of this Fiduciary Fund activity is related to the Commonwealth's Pension Fund detailed in fund statements found in this report.

The \$410 million operating loss in this fund group is the result of two major components:

- The net in value of pension assets increased by \$511 million. However,
- Payments to the unemployed in the Commonwealth exceed employer contributions to the Unemployment Compensation Trust Fund by over \$937 million.

The pension valuation is based on data as of January 1, 2003. Details of this valuation are outlined in note 10. The value of pension assets of the public retirement system dropped from FY02 to FY03 from 81.1% funded to 69.9% funded. This is due to economic conditions and early retirement. Due to market conditions after June 30 and a new early retirement incentive program in effect for FY04, this percentage could be lower.

Fiduciary Fund - Operations (Excluding Non-Expendable Trusts)
(Amounts in thousands)

	2002	2003
Beginning fund balance.....	\$ 30,957,564	\$ 28,083,520
Revenues and other sources:		
Taxes.....	862,033	905,821
Federal reimbursements.....	395,390	744,385
Departmental and other revenues.....	1,624,018	1,950,375
Interfund transfers and other sources.....	29,740	26,245
Unrealized and realized investment earnings / (losses).....	(1,658,292)	967,084
Total revenues and sources.....	1,252,889	4,593,910
Expenditures and other uses:		
Expenditures.....	4,031,260	4,814,732
Interfund transfers.....	95,673	189,217
Total expenditures and uses.....	4,126,933	5,003,949
Excess (deficiency) of revenues and sources over expenditures and uses.....	(2,874,044)	(410,040)
Ending fund balance.....	\$ 28,083,520	\$ 27,673,480

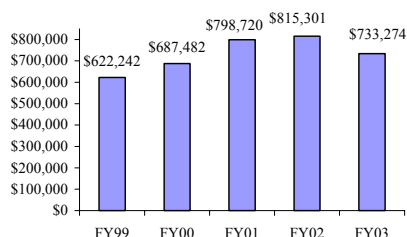
The Non-Appropriated Funds of Higher Education

The SBFR includes the financial operations of the non-appropriated funds of the 25 Institutions of Higher Education in the statistical section of this report. Over the past few years, significant efforts have been taken by our office and the institutions to improve the accuracy and timeliness of this Higher Education segment of the financial report. Each Institution of Higher Education is authorized and directed in its enabling statute to collect, retain and expend certain fees, rents, sales, donations, federal financial participation and other types of revenue through campus based systems. These financial resources are integral parts of the total financial activity of each campus. They also represent resources in addition to amounts made available from Commonwealth appropriations.

Non-Appropriated Funds Of Higher Education - Operations
(Amounts in thousands)

	2002	2003
Beginning fund balance.....	<u>\$ 789,720</u>	<u>\$ 815,301</u>
Revenues and other sources:		
Federal Grants and reimbursements.....	273,617	299,199
Departmental and miscellaneous.....	952,590	719,485
Transfers and other sources	<u>384,434</u>	<u>701,170</u>
Total revenues and other sources.....	<u>1,610,641</u>	<u>1,719,854</u>
Expenditures and other uses:		
Programs and services.....	1,144,925	1,646,136
Transfers and other uses.....	<u>440,135</u>	<u>155,745</u>
Total expenditures and uses.....	<u>1,585,060</u>	<u>1,801,881</u>
Excess (deficiency) of revenues and other sources over expenditures and other uses.....	<u>25,581</u>	<u>(82,027)</u>
Ending fund balance.....	<u><u>\$ 815,301</u></u>	<u><u>\$ 733,274</u></u>

Non-Appropriated Funds of Higher Education – Fund Balance
(Amounts in Thousands)



The Non-Appropriated Funds for Higher Education – Operations table includes the FY03 funds, summarized and compared to FY02. Financial statements for each of the individual funds are included in the statistical section of this report. The graph Non-Appropriated Funds for Higher Education – Fund Balance shows the combined fund balance for the past five years. The combined balance represents \$515 million for the University of Massachusetts, \$122 million for the State College system and \$96 million for the Community Colleges. These balances are designated for specific purposes, such as restrictions on endowments or other specialized purposes specified by the funding contributions.

Conclusion

The Commonwealth has many accomplishments in FY03 of which it can be proud.

The Office of the Comptroller continued its effort to build a more collaborative working relationship among members of this office and Chief Fiscal Officers (CFO) of the Commonwealth in a program we call "PARTNERS in Financial Management." The second CFO conference brought together CFOs from across the Commonwealth for two days of meetings. PARTNERS stands for people, accountability, responsibility, trust, negotiation, efficiency, risk assessment and mitigation, and solutions. We have enhanced the mantra that all systems, big and small, depend on people who are integral to those systems. This recognizes that fiscal officers of the Commonwealth are being given increased authority and at the same time being held accountable for their actions, ensuring a balance of efficiency and integrity of the financial operations of the Commonwealth. We must maintain this standard to maintain the public trust. We strike this balance between efficiency and integrity of operations through constant risk assessment and effective risk mitigation. Finally, we strive to find solutions to many of the Commonwealth's problems in conjunction with the rest of the CFOs, so that full input is heard.

This past December we released the Commonwealth's Comprehensive annual financial report with a new look and feel. With the implementation of GASB Statement 34 the Commonwealth's financial statements now include a more comprehensive view of the financial condition accruing all long-term assets and liabilities on the balance sheet including Commonwealth infrastructure. Underlying the change to this document was an extensive statewide project to:

- value Commonwealth infrastructure at historical cost;
- redesign underlying financial systems; and,
- work with the 25 institutions of Higher Education and 30 public authorities to make changes to their financial systems.

This was a huge multi-department undertaking. It was conducted with no additional funding and has been highly successful.

The Commonwealth has eliminated a number of funds and adopted a more straightforward definition of fiscal balance including all of the budgeted funds. The definition of fiscal balance that had previously only included the fund balance within three of the budgeted funds has been expanded to include all budgeted funds for FY04. In addition the number of budgeted funds has been reduced from 54 to 4. However subsequent to year end the Legislature reinstated the Inland Fisheries and Game Fund and exempted it from the definition of fiscal balance.

The Commonwealth is in the midst of the most significant system upgrade in almost two decades. The Office of the Comptroller and the Information Technology Division have partnered with American Management Systems of Fairfax Virginia, to upgrade the Commonwealth financial management system to a web based architecture. The new system is slated to be completed in time for the

Minor Budgeted Funds Eliminated (Transferred amounts in Thousands)

Fund Name	Fund Balance / (Deficit) Transferred
Minor Budgeted Funds	
Transferred to the Stabilization Fund:	
Child Support Penalty Fee Fund.....	(352)
Brownfields Revitalization Fund.....	924
Firearms Records Keeping Fund.....	2,194
Tobacco Settlement Fund.....	32,404
Antitrust Enforcement Fund.....	(3,320)
Victim and Witness Assistance Fund.....	(14,850)
Intercity Bus Capital Assistance Fund.....	(5,115)
Motorcycle Safety Fund.....	223
Environmental Challenge Fund.....	1,180
Drug Analysis Fund.....	308
Toxics Use Reduction Fund.....	(8,430)
Clean Environment Fund.....	32,795
Environmental Permitting and Compliance Assurance Fund.....	(56,068)
Underground Storage Tank Petroleum Product Cleanup Fund.....	(14,684)
Environmental Law Enforcement Fund.....	(3,957)
Public Access Fund.....	324
Harbors and Inland Waters Maintenance Fund.....	(3,349)
Marine Fisheries Fund.....	(6,981)
Watershed Management Fund.....	(2,525)
Low Level Radioactive Waste Management Fund.....	(432)
Ponkapoag Recreational Fund.....	46
Division of Insurance Fund.....	93
Health Protection Fund.....	51,103
Leo J. Martin Recreational Fund.....	(99)
Clean Air Act Compliance Fund.....	(1,897)
State Building Management Fund.....	4,387
Reggie Lewis Track and Athletic Center Building Fund.....	460
Assisted Living Administrative Fund.....	1,769
Solid Waste Disposal Fund.....	3
Second Century Fund.....	(796)
Safe Drinking Water Fund.....	(105)
Diversity Awareness Education Trust Fund.....	8
Child Care Fund.....	3,551
Transitional Aid to Needy Families Fund..	(5,988)
Social Services Program Fund.....	693
Local Consumer Inspection Fund.....	(574)
Caseload Increase Mitigation Fund.....	31,011
Subtotal - Minor Budgeted Funds.....	33,951
Capital Fund Transferred to of the Stabilization Fund:	
Capital Needs Investment Trust Fund.....	6,854
Net fund balance / (deficit) transferred to the Stabilization Fund.....	\$ 40,805
Budgeted Fund Transferred to the General Fund:	
Local Aid Fund.....	(1,802,426)
Net fund balance / (deficit) transferred to the General Fund....	\$ (1,802,426)

*Zero balance transfers not shown.

opening of FY05. This project will focus on changing business practices in order to minimize customization to this product.

This strategy will insure the Commonwealth can upgrade to current releases in the future at a reasonable cost. The goal is to keep current with technology in the future and at the same time control the total cost of system ownership. Benefits will accrue directly to the users of the financial system. In addition, this updated technology will allow for the future integration of Commonwealth internet-based applications into “back office” financial systems. The Comptroller, the Information Technology Division and AMS have assigned a highly motivated, highly dedicated team to this project to insure its success.

This year’s general appropriation act challenges all within the government to gain efficiencies. Throughout state government agencies and secretariats are trying new ways to consolidate and streamline operations to gain efficiencies. This must be done without compromising the financial or programmatic integrity of state agencies.

One CFO recently being interviewed by the NewMMARS quality assurance team described the challenges of this fiscal year as the “perfect storm.”

- The economic tightening is reducing staff;
- Fiscal officers are being challenged with reorganizations; and,
- A new financial system is going live.

In this environment, the challenge of maintaining effective controls is greater than ever. We continue to ask each department, at its highest levels, to assess its risks and target controls to manage those risks efficiently and effectively. Toward this end, the Office of the Comptroller, in conjunction with the Office of the State Auditor, has continued a multi-pronged effort to improve controls throughout the Commonwealth.

I again would like to express my thanks to the many dedicated employees within the Office of the State Comptroller. We have had another successful year within the office. Our office has undertaken many tasks this year. We are embarking on the redesign of the state accounting system, MMARS. This will be a significant effort but will provide enduring benefits to the Commonwealth. I am proud to have all the employees of the Comptroller’s Office on my team to help tackle these and other difficult issues of the future.

Respectfully submitted,

Martin J. Benison
Comptroller of the Commonwealth